

Date Mailed  
SEPTEMBER 11, 1998

BEFORE THE

PUBLIC SERVICE COMMISSION OF WISCONSIN

Investigation of the Accounting Treatment for  
Account 271, Contributions in Aid of Construction and  
Modification of the Uniform Systems of Accounts for  
Municipal Electric, Gas, Water and Sewer Utilities

OS-US-105

**NOTICE OF INVESTIGATION**

Initial Comments Due:

**Friday, October 30, 1998 - Noon**

FAX Due Date:

**Thursday, October 29, 1998 - Noon**

Address Comments To:

**Clarence Mougín**

Public Service Commission

P.O. Box 7854

Madison, WI 53707-7854

On March 27, 1998, the American Water Works Association PSC Liaison Committee (AWWA) filed a proposal to modify the Uniform System of Accounts (USOA) for the accounting treatment for municipal water contributions in aid of construction (CIAC). A copy of the AWWA proposal is Attachment 1 to this notice. The Public Service Commission of Wisconsin (Commission) decision in this docket may require modification of the municipal electric, gas, and sewer USOA. The AWWA proposal states the water industry objectives are to:

1. Maintain regulatory accounting, as close as possible, to Generally Accepted Accounting Principles,
2. Amortize CIAC account balances to achieve a zero rate of return on the contributed assets,
3. Stop the trend of higher rates of return in customer rate cases, and
4. Maintain equal accounting treatment of contributions for all municipal utilities.

In this investigation the Commission will analyze the effects of the AWWA proposal, provide an opportunity for interested parties to comment on this or other proposals, and assist in defining the issues. These comments will not be a part of the formal record, unless incorporated in testimony at the future hearing.

As background information; the Commission currently accounts for CIAC by two different accounting and ratemaking methods. For private energy and telecommunications companies, CIAC plant is not recorded in the balance sheet or income statement. The contributed plant is not depreciated nor are any carrying costs included in customer rates. An example of this method is included as Attachment 2.

For municipal electric, gas, water and sewer utilities, and small private water utilities the balance sheet includes customer contributed plant in the utility plant accounts with a corresponding credit amount in Account 271, Contributions in Aid of Construction. When determining customer rates, depreciation expense on customer CIAC plant is included in the revenue requirement. When calculating the revenue requirement for return on net investment rate base purposes, the accumulated depreciation on CIAC plant is deducted from rate base in addition to the entire CIAC account balance. In this manner, customers do not pay a rate of return on the plant assets they have contributed nor on the accumulated depreciation expense on CIAC plant. The plant contributed by customers remains on the utility's balance sheet as a permanent capital contribution to the utility, always reducing rate base when determining customer rates, even after the CIAC plant is retired. The accumulated depreciation expense is eliminated when CIAC plant is retired. An example of this method is included as Attachment 3.

The theory in the private energy and telecommunications scenario is basic; remove all costs of contributed plant from the financial statements. None of these costs are included in customer rates. The theory in the municipal and private water scenario is that depreciation expense from contributed plant assets is included in customer rates to provide a cash flow for replacement of older plant assets. However, in this second scenario the contributed plant assets are not included in the net investment rate base; therefore, no rate of return is calculated on customer contributed assets.

"This discussion and the AWWA proposal raise issues for Commission decision in this docket. Please address your comments to each issue listed below:

1. Current Commission prescribed ratemaking treatment excludes customer contributions from rate base. Customers do not pay a return on the plant constructed with their capital. Under the AWWA proposal, customers will pay a return on a larger net rate base. Your comments should compare and contrast the present ratemaking considerations for customer plant contributions with the AWWA zero net investment rate base proposal.
2. Current Commission prescribed ratemaking treatment for municipal water, electric, gas, and sewer utilities for contributed plant **initially** results in a rate base of zero. In subsequent years, the rate base becomes negative as depreciation expense is recorded on the contributed plant. Comment on the appropriateness that contributed plant is depreciated when the utility incurred no capital cost for that plant.
3. Current Commission prescribed ratemaking treatment for municipal water, electric, gas, and sewer utilities deducts CIAC when calculating rate base. Current Commission prescribed ratemaking treatment includes contributions from municipalities in rate base. Comment on the advantages and/or disadvantages of accounting for Account 271, Contributions in Aid of Construction and Account 200, Capital Paid in by Municipality in a like manner.

4. The GASB Codification, Section 660.116 is applicable only to assets contributed by governments outside the financial reporting entity (federal or state sources). Discuss the advantages and/or disadvantages of applying the AWWA proposal to only grants from governmental bodies, as opposed to all contributions in account 271.
5. An alternative ratemaking treatment for CIAC considers customer contributions as a zero cost of capital. This alternative continues to depreciate CIAC, the present Commission accounting treatment, but would not subtract CIAC from the rate base calculations. CIAC is added to the capital structure as a zero cost in arriving at the weighted cost of capital. Discuss the advantages/disadvantages of accounting for CIAC as no cost capital in deriving a weighted cost of capital. An example of this method is included as Attachment 4.
6. Discuss, as an alternative proposal, the adoption of the Commission private electric and gas accounting and ratemaking treatment of CIAC for municipal utilities. This method is sometimes referred to as the Federal Energy Regulatory Commission (FERC) or Federal Communications Commission (FCC) Method. See Attachment 2.
7. Please identify any other accounting or ratemaking alternatives to account for CIAC which equitably address both customer and utility concerns.
- '8. The AWWA proposal expresses a concern that rates of return are increasing. Discuss the reasons why higher rates of return may be inappropriate for municipal utilities.
9. Pursuant to s. 66.069(1)(c), stats. and s. PSC 109, Wis. Adm. Code, utilities pay tax equivalents to the municipality calculated on the gross book value of plant, and materials and supplies. Discuss the impact that modification or complete removal of CIAC from the gross book value of plant would have on tax equivalency payments.
10. Discuss the present Commission accounting treatment of CIAC and its impact on the utilities' cash flows, balance sheet and income statement.
11. If modifications are made to the USOA, discuss whether the changes should be made on a prospective basis only or should reclassification of historical CIAC plant dollars also be considered.
12. If the Commission decision required an amortization of CIAC balances, discuss how a reasonable amortization period should be determined.

**All interested parties must file for full party status to participate in this proceeding. Full party status applications may be requested from the Examining Division, Public Service Commission of Wisconsin, P.O. Box 7854, Madison, WI 53707-7854.**

Docket OS-US-105

The Commission requests the above issues to be fully addressed by the interested parties. All parties should reference this docket (OS-US-105) when submitting their comments. It will be helpful to Commission staff if interested parties include proposed accounting entries in their comments. All comments received by the Commission will be compiled by Commission staff and mailed to all interested parties. All parties will have the opportunity to respond with rebuttal comments to the Commission. Initial comments will be due at noon on October 30, 1998. Reply comments will be due at noon on December 18, 1998. At the end of the comment periods, a hearing date and dates for filing testimony will be set. The Commission will issue its decision with respect to CIAC based upon the record established in this docket.

This is a Type 3 action under s. PSC 4.10(3), Wis. Adm. Code. Furthermore, since no unusual circumstances have come to the attention of the Commission which indicate that significant environmental consequences are likely, neither an environmental impact statement under s. 1.11, Stats., nor an environmental assessment is required.

Questions regarding this matter may be directed to Clarence Mouglin at (608) 267-0637 or Douglas Sorge at (608) 267-3799.

Dated at Madison, Wisconsin                      ~~~:~sr.~

By the Commission.

Lynda L. Dorr  
Secretary to the Commission

CEM:bhh:mlo:G:\NOTICE\PENDING\S-US-105 CIAC.doc

Attachments

Attachment 1: Water Industry CIAC Proposal

Attachment 2: Private energy and telecommunications CIAC method

Attachment 3: Municipal electric, gas, water and sewer utility CIAC method

Attachment 4: Zero cost of capital CIAC method



**OAK CREEK**

**WATER and SEWER UTILITY**  
**170 West Crest Avenue. Oak Creek**

ATTACHMENT 1  
PAGE 1 of 6

MEMORANDUM

To: PSCW Staff Accounting Policy Team  
From: Steven N. Yttri, CPA **SNY**  
Finance Director  
Subject: Water Industry CIAC Proposal  
Date: March 27, 1998

Received  
MAR 30  
DIV. OF WATER, COMPLIANCE  
AND CONSUMER AFFAIRS

On behalf of the water industry, I have enclosed our proposal for accounting for CIAC. The format was based on the 1996 PSC Annual Report and Oak Creek Water Utility's 1996 financial data- Contained in this proposal are all of the water industry's objectives as follows:

1. That regulatory accounting should remain as close as possible to Generally Accepted Accounting Principles. Our example combines all equity accounts and places them on one line of the balance sheet called Fund Equity. We have also added a line to the Income Statement in Other Income titled Capital Contributions. These changes conform to the currently outstanding GASB Financial Reporting Model Exposure Draft (ED) and do not affect rate of return calculations.
2. The proposal to amortize CIAC involves a zero rate of return on the related assets. The initial rate base for a CIAC asset is zero. We are requesting a rate base in years after year one what is allowed in year one (zero).
3. To stop the trend of higher rates of return. As CIAC assets are depreciated, rates of return will have to be higher in order offset the negative rate of return associated with these assets. Our expectation is that rates of return will revert to traditional municipal levels. We feel that both the water industry and the Commission should agree that double digit rates of return are not appropriate for tax exempt utilities.
4. Most importantly, we believe the PSC's current system of determining rates does not treat all utilities equally. Specifically, the two different types of contributions (Capital paid in by municipality and CIAC) are handled oppositely. Assets acquired with municipal contributions (Capital paid in by municipality) are added to rate base while assets acquired with developer contributions (CIAC) are deducted from rate base. To a utility there is no other distinction between the two types of contributions except for rate making. Since utilities typically do not determine the policies that determine the type of contribution (ad valorem tax versus special assessment), the water industry views the opposite rate base treatment for two similar types of contributions as inequitable.

PSC Liaison Committee  
Page 2  
March 27, 1998

Please review our enclosed proposal carefully. The most significant change is the addition of the Accumulated Amortization of CIAC schedule. This schedule was designed to amortize CIAC at a rate that would maintain a zero rate base. The other changes are intended to conform to the ED that was mentioned above. The key elements to comply are: (1) the addition of Capital Contributions to the Income Statement; and (2) the consolidation of all equity accounts to form one Fund Equity line. Please note that we maintain separate schedules for all equity accounts.

Representatives from the water industry are planning to attend the April 1, 1998 SAPT meeting and will be able to answer any of your questions at that time.

Enclosure

cc: Dick Stehmeier  
Jim Kelly  
Ken Blomberg

r

				<b>F-1</b>	1	
					2	
<b>INCOME AND FUND EQUITY STATEMENT</b>					3	<b>Renamed</b>
Particulars	Page	This Year	Last Year		4	
(a)	(b)	(c)	(d)		5	
<b>UTILITY OPERATING INCOME</b>					6	
Operating revenues (400)		4,147,555	3,645,755		7	
Aerating expenses:					8	
Operation expense (401)		1,356,902	1,163,475		9	
Maintenance expense (402)		433,495	284,562		10	
Depreciation expense (403)		609,139	558,191		11	
Amortization expense (404-406)					12	
Amortization of property losses (407)					13	
Taxes (408)		970,088	1,006,556		14	
Total operating expenses et operating income Income		3,369,624	1,184		15	
from util. plant leased to others (412-413) Utility					16	
operating income	<b>F-14</b>	777,931	632,971		17	
<b>OTHER INCOME</b>					18	
Income from merch., job. & cont. work 415-416)					19	
Income from nonutil operations 417	<b>F-14</b>	12,562	12,539		20	
Nonoperating rental 418	<b>F-14</b>				21	
Interest and dividend income 419	<b>F-14</b>	219,823	356,250		22	
Miscellaneous nonoperating income 421	<b>F-14</b>	670,759			23	
Capital Contributions	<b>F-14</b>	903,144			24	
Other income	<b>F-10</b>				24A	New
Total income		1,681,075			25	
<b>MISCELLANEOUS INCOME DEDUCTIONS</b>					26	
					27	
Miscellaneous amortization (425)	<b>F-15</b>				28	
Other income deduction (426)	<b>F-15</b>				29	
Total income deductions					30	
Income before interest charges		1,681,075	1,001,760		31	
<b>INTEREST CHARGES</b>					32	
Interest on long-term debt (427)	<b>F-13</b>	448,577	288,508		33	
Amortization of debt discount and expense 428)	<b>F-9</b>	41,138	28,147		34	
Amortization of premium on debt-cr. 429)	<b>F-9</b>				35	
Interest on debt to municipality (430)	<b>F-13</b>				36	
Other interest expense 431)	<b>F-13</b>				37	
Interest charged to construction-a. (432)		119,960	32,689		38	
Total interest charges		369,755	83,966		39	
Net income		1,311,320	717,794		40	
<b>FUND EQUITY</b>					41	
Fund Equity (beg. of period) (200-216 & 271)	<b>F-3</b>	37,157,436	36,439,642		42	Renamed
Change:					43	Restated
Balance transferred from income 433		1,311,320	717,794		44	
Miscellaneous credits to surplus 434	<b>F-10</b>				45	
Miscellaneous debits to surplus 435	<b>F-10</b>				46	
Appropriations of surplus 436	<b>F-10</b>				47	
Appropriations of income to municipal funds (439)	<b>F-10</b>				48	
Net change to fund equity		1,111,20	71,794		49	
Fund equity end of year (200-216 & 271)		38,46,156	37,157,436		50	

			F-3	1	
				2	
BALANCE SHEET				3	
		Balance End	Balance First	4	
Liabilities and Other Credits	Page	of Year	of Year	5	
a	b	c	d	6	
FUND EQUITY				7	Renamed
				8	Deleted
				9	Deleted
				10	Deleted
Fund Equity (200-216 & 271)	F-10	38,468,756	37,157,436	11	Renamed
LONG-TERM DEBT				12	
Bonds 221-222	F-11	11,100,000	8,280,000	13	
Advances from Municipality 223	F-12	1,110,000	1,332,000	14	
Other long-term debt (224)	F-13			15	
Total long-term debt -		12,200,000	,61,000	16	
CURRENT ACCRUED LIABILITIES				17	
Notes payable 231	F-12			18	
Accounts payable 232		280,539	766,331	19	
Payables to municipality 235	F-7	277,341	401,868	20	
Customer deposits 235				21	
Taxes accrued 236	F-11	937,801	956,726	22	
Interest accrued 237	F-13	83,989	210,289	23	
Matured long-term debt 39				24	
Matured interest 240				25	
Tax collections payable 241				26	
Misc. current and accrued liabilities (242)		13,920		27	
Total current and accrued liabilities		1,59,59	,24	28	
DEFERRED CREDITS				29	
Unamortized premium on debt 251	F-9			30	
Customer advances for construction 252				31	
Other deferred credits (253)	F-7	14,013	12,792	32	
		14,01	1,92	33	
Total deferred credits					
OPERATING RESERVES				34	
Property insurance reserve 261				35	
Injuries and damages reserve 262				36	
Pension and benefits reserve (263)				37	
Miscellaneous operating reserves (265)				38	
Total operating reserves				39	
				40	Deleted
				41	~ Deleted
Total liabilities and other credits		52,286,359	49,117,442	42	-



FUND EQUITY (Accounts 200-216 & 271)		F-10	New
		22	
Particulars	Amount	23	
a	b	24	
Capital Paid in by municipality Account 200 :		25	
Balance first of year	10,386,213	26	
Changes during the year (explain fully):		27	
		28	
Net changes	0	29	New
Balance end of year	10,386,213	30	
		31	
Appropriated earned surplus 215		32	
Balance first of year		33	
Changes during the year (explain fully)		34	
		35	
		36	
		37	
		38	
		39	
Balance end of year	one	40	
		41	
Unappropriated earned surplus 216		42	
Balance first of year	5,261,574	43	
Add credits from amortization of CIAC assets (F-13, line 65)	436,901	44	New
		45	
Other changes during the year (explain fully):		46	
		47	
Net Income	1,311,320	48	
Less: Capital Contributions	670,759	49	
		50	
		51	
		52	
		53	
		54	
		55	
Balance end of year	6,339,361	56	
		57	
Net contributions in aid of construction (see F-13, line 72)	21,743,507	58	New
		59	
Total net equity (page -1, line 50)	38,468,756	60	New
		61	
Capital Contributions		62	
Account 200 net changes F-10, line 29	0	63	New
Account 271 net changes (F-1.3, line 55)	670,759	64	New
Contributions (F-1, line 24A)	670,759	65	- - ~ New

					F-13		
t CONTRIBUTIONS IN AID OF		CONSTRUCTION (Account 271) 40					
Particulars	Water	Electric	Other	Sewer	Total		41t
a	b	Distribution c	d	e			42t
Balance first of ear	21,509,649				21,509,649		43t
Add credits during ear.							44
For services	58,368				58,368		45
For mains	581,427				581,427		46
Other s							47
Hydrants	30,964				30,964		48
							49
Deduct charges (specify):							50
							51
							52
							53
							54
Net than es	670,759				670,759		55New
Balance en o ear	,18 ,408				,18 ,4		56
							57New
ACCUMULATED AMORTIZATION OF CIAC (Account 271.1							58New
Particulars				Amount	Amount		59New
a				b	c		60New i
Balance first of ear					0		61New
							62New
Average CIAC balance (F-13, lines 44+56/2)				21,845,029			63New
Amortization rate				2.00%r6			64New
Amortization					436,901.		65New
							66New
Other changes during the ear							67New
							68New
Net than es					436,901		69New
Balance end of ear					4 6,901		70New
							71New
Net contributions in aid of construction F-13, lines 56-70					21,743,507		72New

**Present Commission CIAC Method  
For Private Energy and Telecommunications Utilities  
CIAC Deducted from Rate Base and Capital Structure  
CIAC Not Depreciated**

**BEGINNING OF YEAR ONE**

## Calculation of Rate Base

## Capital Structure

	Amount		Amount	%	Cost	Weighted Cost
Plant	\$ 15,000	Equity	\$ 9,000	60%		10.0%
	6.00%					
CIAC	\$ -	Debt	\$ 6,000	40%	6.0%	2.40%
Acc. Dep.		CIAC	\$ -	0%	0.0%	0.00%
Rate Base	\$ 15,000	Total	\$ 15,000		100%	8.40%

Total amount of CIAC is \$5,000. In this Commission CIAC method all CIAC balances are never recorded in gross plant and are not used in rate of return calculations. CIAC is also not included in the capital structure.

The result of the present Commission CIAC method in this example is a rate of return of 8.4%. The rate of return (8.4%) times the total rate base (\$15,000) equals a dollar rate of return of \$1260. Depreciation expense is taken on only a \$15,000 plant balance (excludes CIAC).

## Partial Revenue Requirement Calculation

Rate of Return Component	\$ 1,260
Depreciation Expense Component	\$ 300
Assume 50 year life 2% depreciation rate	

**Present Commission CIAC Method  
For Private Energy and Telecommunications Utilities  
CIAC Deducted from Rate Base and Capital Structure  
CIAC Not Depreciated**

**BEGINNING OF YEAR TWO**

Calculation of Rate Base			Capital Structure			Weighted
	Amount		Amount	%	Cost	Cost
Plant	\$ 15,000	Equity	\$ 8,700	59%		10.0%
	5.92%					
CIAC	\$ -	Debt	\$ 6,000	41 %	6.0%	2.45%
Acc. Dep.	\$ (300)	CIAC	\$ -	0%	0.0%	0.00%
Rate Base	\$ 14,700	Total	\$ 14,700		100%	8.37%

Total amount of CIAC is still \$5,000. In this Commission CIAC method all CIAC balances are never recorded in gross plant and are not used in rate of return calculations. CIAC is also not included in the capital structure.

The result of the present Commission CIAC method in the second year is a rate of return of 8.37%. The rate of return (8.37%) times the total rate base (\$14,700) equals a dollar rate of return of \$1230. Depreciation expense is taken only on a \$15,000 plant balance (excludes CIAC).

**Partial Revenue Requirement Calculation**

Rate of Return Component	\$ 1,230
Depreciation Expense Component	\$ 300
Assume 50 year life, 2% depreciation rate	
Total	\$ 1,530

NOTE: The rate of return calculations assume an annual net loss equal to the amount of the depreciation

**Present Commission CIAC Method  
For Municipally Owned Utilities CIAC  
Deducted from Rate Base CIAC  
Depreciated**

**BEGINNING OF YEAR ONE**

Calculation of Rate Base

Capital Structure

	Amount		Amount	%	Cost	Weighted Cost
Plant	\$ 20,000	Equity	\$ 9,000	60%	10.0%	6.00%
CIAC	\$ (5,000)	Debt	\$ 6,000	40%	6.0%	2.40%
Acc. Dep.		CIAC	\$ -	0%	0.0%	0.00%
Rate Base	\$ 15,000	Total	\$ 15,000	100%		8.40%

Total amount of CIAC is \$5,000. In the present Commission CIAC method this amount is deducted from gross plant in the calculation of rate base. CIAC is not included in the capital structure.

The result of the present Commission CIAC method in this example is a rate of return of 8.4%. The rate of return (8.4%) times the total rate base (\$15,000) results in a dollar rate of return of \$1260. Depreciation expense is taken on the full \$20,000 plant balance (includes CIAC).

Partial Revenue Requirement Calculation

Rate of Return Component	\$ 1,260 .
Depreciation Expense Component	\$ 400
Assume 50 year life, 2% depreciation rate	
Total	\$ 1,660

**Present Commission CIAC Method  
For Municipally Owned Utilities CIAC  
Deducted from Rate Base CIAC  
Depreciated**

**BEGINNING OF YEAR TWO**

## Calculation of Rate Base

## Capital Structure

	Amount		Amount	%	Cost	Weighted Cost
Plant	\$ 20,000	Equity	\$ 8,600	59%	10.0%	5.89%
CIAC	\$ (5,000)	Debt	\$ 6,000	41 %	6.0%	2.47%
Acc. Dep.	\$ (400)	CIAC	\$ -	0%	0.0%	0.00%
Rate Base	\$ 14,600	Total	\$ 14,600	100%		8.36%

Total amount of CIAC is \$5,000. In this Commission CIAC method all CIAC balances are never recorded in gross plant and are not used in rate of return calculations. CIAC is also not included in the capital structure.

The result of the present Commission CIAC method in the second year is a rate of return of 8.36%. The rate of return (8.36%) times the total rate base (\$14,600) equals a dollar rate of return of \$1220. Depreciation expense is taken on the full \$20,000 plant balance (includes CIAC).

## Partial Revenue Requirement Calculation

Rate of Return Component	\$ 1,220
Depreciation Expense Component	\$ 400
Assume 50 year life, 2% depreciation rate	
Total	\$ 1,620

NOTE: The rate of return calculations assume an annual net loss equal to the amount of the depreciation expense, which is deducted both from equity and rate base.

**Zero Cost of Capital CIAC Method**  
**CIAC Treated as No Cost Capital**  
**CIAC Depreciated**

**BEGINNING OF YEAR ONE**

## Calculation of Rate Base

## Capital Structure

	Amount		Amount	%	Cost	Weighted Cost
Plant	\$ 20,000	Equity	\$ 9,000	45%	10.00%	4.50%
		Debt	\$ 6,000	30%	6.00%	1.80%
Acc. Dep.	\$ -	CIAC	\$ 5,000	25%	0.00%	0.00%
Rate Base	\$ 20,000	Total	\$ 20,000	100%		6.30%

Total amount of CIAC is \$5,000. In a zero cost of capital CIAC method this amount is included in the calculation of rate base. The \$5,000 CIAC is also included in the capital structure with a zero cost of capital.

The result of a zero cost of capital for CIAC in this example is a rate of return of 6.3%. The rate of return (6.3%) times the total rate base (\$20,000) equals a dollar rate of return of \$1,260.

Depreciation expense is taken on the full \$20,000 plant balance (includes CIAC).

## Partial Revenue Requirement Calculation

Rate of Return Component	\$	1,260
Depreciation Expense Component	\$	400
Assume 50 year life, 2% depreciation rate		
Total	\$	1,660

**Zero Cost of Capital CIAC Method**  
**CIAC Treated as No Cost Capital**  
**CIAC Depreciated**

**BEGINNING OF YEAR TWO**

<u>Calculation of Rate Base</u>		<u>Capital Structure</u>			Weighted
	Amount		<u>Amount</u>	Cost	Cost
Plant	\$ 20,000	Equity	\$ 8,600	43.88%	10.00%
		Debt	\$ 6,000	30.61 %	6.00%
Acc. Dep. \$ (400)		CIAC	<u>\$ 5,000</u>	25.51%	0.00%
Rate Base <u>\$ 19,600</u>		Total	\$ 19,600	100.00%	<u>6.22%</u>

Total amount of CIAC is \$5,000. In a zero cost of capital CIAC method this amount is included in the calculation of rate base. The \$5,000 CIAC is also included in the capital structure with a zero cost of capital.

The result of a zero cost of capital for CIAC in the second year is a rate of return of 6.22%. The rate of return (6.22%) times the total rate base (\$19,600) equals a dollar rate of return of \$1,220. Depreciation expense is taken on the full \$20,000 plant balance (includes CIAC).

**Partial Revenue Requirement Calculation**

Rate of Return Component	\$	1,220
Depreciation Expense Component	\$	400
Assume 50 year life, 2% depreciation rate		
Total	<u>\$</u>	<u>1,620</u>

NOTE: The rate of return calculations assume an annual net loss equal to the amount of the depreciation expense, which is deducted both from equity and rate base.